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AICPA Professional Standards: Statements on standards for tax services as of June 1, 2004

American Institute of Certified Public Accountants. Tax Executive Committee

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AICPA Professional Standards

Volume 2

Accounting and Review Services

Code of Professional Conduct

Bylaws

Consulting Services

Quality Control

Peer Review

Tax Services

Personal Financial Planning

Continuing Professional Education

As of June 1, 2004

STATEMENTS ON STANDARDS FOR TAX SERVICES

Preface

Practice standards are the hallmark of calling one's self a professional. Members should fulfill their responsibilities as professionals by instituting and maintaining standards against which their professional performance can be measured. Compliance with professional standards of tax practice also confirms the public's awareness of the professionalism that is associated with CPAs as well as the AICPA.

This Publication sets forth ethical tax practice standards for members of the AICPA: Statements on Standards for Tax Services (SSTSs or Statements). Although other standards of tax practice exist, most notably Treasury Department Circular No. 230 and penalty provisions of the Internal Revenue Code (IRC), those standards are limited in that (1) Circular No. 230 does not provide the depth of guidance contained in these Statements, (2) the IRC penalty provisions apply only to income-tax return preparation, and (3) both Circular No. 230 and the penalty provisions apply only to federal tax practice.

The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to meet a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01], will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

History

The SSTSs have their origin in the Statements on Responsibilities in Tax Practice (SRTPs), which provided a body of advisory opinions on good tax practice. The guidelines as originally set forth in the SRTPs had come to play a much more important role than most members realized. The courts, Internal Revenue Service, state accountancy boards, and other professional organizations recognized and relied on the SRTPs as the appropriate articulation of professional conduct in a CPA's tax practice. The SRTPs, in and of themselves, had become de facto enforceable standards of professional practice, because state disciplinary organizations and malpractice cases in effect regularly held CPAs accountable for failure to follow the SRTPs when their professional practice conduct failed to meet the prescribed guidelines of conduct.

The AICPA's Tax Executive Committee concluded that appropriate action entailed issuance of tax practice standards that would become a part of the Institute's Code of Professional Conduct. At its July 1999 meeting, the AICPA Board of Directors approved support of the executive committee's initiative and placed the matter on the agenda of the October 1999 meeting of the Institute's governing Council. On October 19, 1999, Council approved designating the Tax Executive Committee as a standard-setting body, thus authorizing that committee to promulgate standards of tax practice. These SSTs, largely mirroring the SRTPs, are the result.

The SRTPs were originally issued between 1964 and 1977. The first nine SRTPs and the Introduction were codified in 1976; the tenth SRTP was issued in 1977. The original SRTPs concerning the CPA's responsibility to sign the return (SRTPs No. 1, *Signature of Preparers*, and No. 2, *Signature of Reviewer: Assumption of Preparer's Responsibility*) were withdrawn in 1982 after Treasury Department regulations were issued adopting substantially the same standards for all tax return preparers. The sixth and seventh SRTPs, concerning the responsibility of a CPA who becomes aware of an error, were revised in 1991. The first Interpretation of the SRTPs, Interpretation 1-1, "Realistic Possibility Standard," was approved in December 1990. The SSTs and Interpretation supersede and replace the SRTPs and their Interpretation 1-1 effective October 31, 2000. Although the number and names of the SSTs, and the substance of the rules contained in each of them, remain the same as in the SRTPs, the language has been edited to both clarify and reflect the enforceable nature of the SSTs. In addition, because the applicability of these standards is not limited to federal income-tax practice, the language has been changed to mirror the broader scope.

Ongoing Process

The following Statements on Standards for Tax Services [sections 100–800] and Interpretations No. 1-1, "Realistic Possibility Standard," and No. 1-2, "Tax Planning," [section 9100] to Statement No. 1, *Tax Return Positions* [section 100] reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The Statements are intended to be part of an ongoing process that may require changes to and interpretations of current SSTs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members.

The Tax Executive Committee promulgates SSTs. Even though the 1999-2000 Tax Executive Committee approved this version, acknowledgment is also due to the many members whose efforts over the years went into the development of the original statements.

[The next page is 18,011.]

TS Section**TAX SERVICES**

STATEMENTS ON STANDARDS FOR TAX SERVICES

The Statements on Standards for Tax Services (SSTs) and Interpretations, promulgated by the Tax Executive Committee, reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The Statements are intended to be part of an ongoing process that may require changes to and Interpretations of current SSTs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. Interpretation No. 1-2 was approved by the Tax Executive Committee on August 21, 2003; its effective date is December 31, 2003.

The SSTs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for Interpretations to meet a broad range of personal and professional situations. The SSTs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, General Standards, and Rule 202, Compliance With Standards, will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

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TS Section 100

Tax Return Positions

Issue date, unless
otherwise indicated:
August, 2000

Introduction

.01 This Statement sets forth the applicable standards for members when recommending tax return positions and preparing or signing tax returns (including amended returns, claims for refund, and information returns) filed with any taxing authority. For purposes of these standards, a *tax return position* is (a) a position reflected on the tax return as to which the taxpayer has been specifically advised by a member or (b) a position about which a member has knowledge of all material facts and, on the basis of those facts, has concluded whether the position is appropriate. For purposes of these standards, a *taxpayer* is a client, a member's employer, or any other third-party recipient of tax services.

Statement

.02 The following standards apply to a member when providing professional services that involve tax return positions:

- a. A member should not recommend that a tax return position be taken with respect to any item unless the member has a good-faith belief that the position has a realistic possibility of being sustained administratively or judicially on its merits if challenged.
- b. A member should not prepare or sign a return that the member is aware takes a position that the member may not recommend under the standard expressed in paragraph .02a.
- c. Notwithstanding paragraph .02a, a member may recommend a tax return position that the member concludes is not frivolous as long as the member advises the taxpayer to appropriately disclose. Notwithstanding paragraph .02b, the member may prepare or sign a return that reflects a position that the member concludes is not frivolous as long as the position is appropriately disclosed.
- d. When recommending tax return positions and when preparing or signing a return on which a tax return position is taken, a member should, when relevant, advise the taxpayer regarding potential penalty consequences of such tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.03 A member should not recommend a tax return position or prepare or sign a return reflecting a position that the member knows—

- a. Exploits the audit selection process of a taxing authority.
- b. Serves as a mere arguing position advanced solely to obtain leverage in the bargaining process of settlement negotiation with a taxing authority.

.04 When recommending a tax return position, a member has both the right and responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

Explanation

.05 Our self-assessment tax system can function effectively only if taxpayers file tax returns that are true, correct, and complete. A tax return is primarily a taxpayer's representation of facts, and the taxpayer has the final responsibility for positions taken on the return.

.06 In addition to a duty to the taxpayer, a member has a duty to the tax system. However, it is well established that the taxpayer has no obligation to pay more taxes than are legally owed, and a member has a duty to the taxpayer to assist in achieving that result. The standards contained in paragraphs .02, .03, and .04 recognize the members' responsibilities to both taxpayers and to the tax system.

.07 In order to meet the standards contained in paragraph .02, a member should in good faith believe that the tax return position is warranted in existing law or can be supported by a good-faith argument for an extension, modification, or reversal of existing law. For example, in reaching such a conclusion, a member may consider a well-reasoned construction of the applicable statute, well-reasoned articles or treatises, or pronouncements issued by the applicable taxing authority, regardless of whether such sources would be treated as *authority* under Internal Revenue Code section 6662 and the regulations thereunder. A position would not fail to meet these standards merely because it is later abandoned for practical or procedural considerations during an administrative hearing or in the litigation process.

.08 If a member has a good-faith belief that more than one tax return position meets the standards set forth in paragraph .02, a member's advice concerning alternative acceptable positions may include a discussion of the likelihood that each such position might or might not cause the taxpayer's tax return to be examined and whether the position would be challenged in an examination. In such circumstances, such advice is not a violation of paragraph .03a.

.09 In some cases, a member may conclude that a tax return position is not warranted under the standard set forth in paragraph .02a. A taxpayer may, however, still wish to take such a position. Under such circumstances, the taxpayer should have the opportunity to take such a position, and the member may prepare and sign the return provided the position is appropriately disclosed on the return or claim for refund and the position is not frivolous. A frivolous position is one that is knowingly advanced in bad faith and is patently improper.

.10 A member's determination of whether information is appropriately disclosed by the taxpayer should be based on the facts and circumstances of the particular case and the authorities regarding disclosure in the applicable taxing jurisdiction. If a member recommending a position, but not engaged to prepare or sign the related tax return, advises the taxpayer concerning appropriate disclosure of the position, then the member shall be deemed to meet these standards.

.11 If particular facts and circumstances lead a member to believe that a taxpayer penalty might be asserted, the member should so advise the taxpayer

and should discuss with the taxpayer the opportunity to avoid such penalty by disclosing the position on the tax return. Although a member should advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

.12 For purposes of this Statement, preparation of a tax return includes giving advice on events that have occurred at the time the advice is given if the advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a tax return.

[The next page is 18,031.]

TS Section 9100

Tax Return Positions: Tax Services Interpretations of Section 100

1-1. Realistic Possibility Standard

Background

.01 Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100], contains the standards a member should follow in recommending tax return positions and in preparing or signing tax returns. In general, a member should have a good-faith belief that the tax return position being recommended has a realistic possibility of being sustained administratively or judicially on its merits, if challenged. The standard contained in SSTS No. 1, paragraph 2a [section 100.02a], is referred to here as the realistic possibility standard. If a member concludes that a tax return position does not meet the realistic possibility standard:

- a. The member may still recommend the position to the taxpayer if the position is not frivolous, and the member recommends appropriate disclosure of the position; or
- b. The member may still prepare or sign a tax return containing the position, if the position is not frivolous, and the position is appropriately disclosed.

.02 *A frivolous position* is one that is knowingly advanced in bad faith and is patently improper (see SSTS No. 1, paragraph 9 [section 100.09]). A member's determination of whether information is appropriately disclosed on a tax return or claim for refund is based on the facts and circumstances of the particular case and the authorities regarding disclosure in the applicable jurisdiction (see SSTS No. 1, paragraph 10 [section 100.10]).

.03 If a member believes there is a possibility that a tax return position might result in penalties being asserted against a taxpayer, the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, of avoiding such penalties through disclosure (see SSTS No. 1, paragraph 11 [section 100.11]). Such advice may be given orally.

General Interpretation

.04 To meet the realistic possibility standard, a member should have a good-faith belief that the position is warranted by existing law or can be supported by a good-faith argument for an extension, modification, or reversal of the existing law through the administrative or judicial process. Such a belief should be based on reasonable interpretations of the tax law. A member should not take into account the likelihood of audit or detection when determining whether this standard has been met (see SSTS No. 1, paragraphs 3a and 8 [section 100.03a and .08]).

.05 The realistic possibility standard is less stringent than the substantial authority standard and the more likely than not standard that apply under the Internal Revenue Code (IRC) to substantial understatements of liability by taxpayers. The realistic possibility standard is stricter than the reasonable basis standard that is in the IRC.

.06 In determining whether a tax return position meets the realistic possibility standard, a member may rely on authorities in addition to those evaluated when determining whether substantial authority exists under IRC section 6662. Accordingly, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of tax analyses commonly used by tax advisers and preparers of returns.

.07 In determining whether a realistic possibility exists, a member should do all of the following:

- Establish relevant background facts
- Distill the appropriate questions from those facts
- Search for authoritative answers to those questions
- Resolve the questions by weighing the authorities uncovered by that search
- Arrive at a conclusion supported by the authorities

.08 A member should consider the weight of each authority to conclude whether a position meets the realistic possibility standard. In determining the weight of an authority, a member should consider its persuasiveness, relevance, and source. Thus, the type of authority is a significant factor. Other important factors include whether the facts stated by the authority are distinguishable from those of the taxpayer and whether the authority contains an analysis of the issue or merely states a conclusion.

.09 The realistic possibility standard may be met despite the absence of certain types of authority. For example, a member may conclude that the realistic possibility standard has been met when the position is supported only by a well-reasoned construction of the applicable statutory provision.

.10 In determining whether the realistic possibility standard has been met, the extent of research required is left to the professional judgment of the member with respect to all the facts and circumstances known to the member. A member may conclude that more than one position meets the realistic possibility standard.

Specific Illustrations

.11 The following illustrations deal with general fact patterns. Accordingly, the application of the guidance discussed in the General Interpretation section to variations in such general facts or to particular facts or circumstances may lead to different conclusions. In each illustration there is no authority other than that indicated.

.12 *Illustration 1*—A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.

.13 *Conclusion*—The member should recommend the return position supported by the new statute. A position contrary to a constitutional, clear, and unambiguous statute would ordinarily be considered a frivolous position.

.14 Illustration 2—The facts are the same as in Illustration 1 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favorable to the taxpayer.

.15 Conclusion—In a case where the statute is clearly and unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically addressing the taxpayer's situation, a return position based either on the statutory language or on the legislative history satisfies the realistic possibility standard.

.16 Illustration 3—The facts are the same as in Illustration 1 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the situation.

.17 Conclusion—In a case where the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not meet the realistic possibility standard. However, because the legislative history provides some support or evidence for the taxpayer's position, such a return position is not frivolous. A member may recommend the position to the taxpayer if the member also recommends appropriate disclosure.

.18 Illustration 4—A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognized to contain a drafting error, and a technical correction proposal has been introduced. The taxing authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.

.19 Conclusion—Return positions based on either the existing statutory language or the taxing authority pronouncement satisfy the realistic possibility standard.

.20 Illustration 5—The facts are the same as in Illustration 4 except that no taxing authority pronouncement has been issued.

.21 Conclusion—In the absence of a taxing authority pronouncement interpreting the statute in accordance with the technical correction, only a return position based on the existing statutory language will meet the realistic possibility standard. A return position based on the proposed technical correction may be recommended if it is appropriately disclosed, since it is not frivolous.

.22 Illustration 6—A taxpayer is seeking advice from a member regarding a recently amended statute. The member has reviewed the statute, the legislative history that specifically addresses the issue, and a recently published notice issued by the taxing authority. The member has concluded in good faith that, based on the statute and the legislative history, the taxing authority's position as stated in the notice does not reflect legislative intent.

.23 Conclusion—The member may recommend the position supported by the statute and the legislative history because it meets the realistic possibility standard.

.24 Illustration 7—The facts are the same as in Illustration 6 except that the taxing authority pronouncement is a temporary regulation.

.25 Conclusion—In determining whether the position meets the realistic possibility standard, a member should determine the weight to be given the regulation by analyzing factors such as whether the regulation is legislative or

interpretative, or if it is inconsistent with the statute. If a member concludes that the position does not meet the realistic possibility standard, because it is not frivolous, the position may nevertheless be recommended if the member also recommends appropriate disclosure.

.26 Illustration 8—A tax form published by a taxing authority is incorrect, but completion of the form as published provides a benefit to the taxpayer. The member knows that the taxing authority has published an announcement acknowledging the error.

.27 Conclusion—In these circumstances, a return position in accordance with the published form is a frivolous position.

.28 Illustration 9—A taxpayer wants to take a position that a member has concluded is frivolous. The taxpayer maintains that even if the taxing authority examines the return, the issue will not be raised.

.29 Conclusion—The member should not consider the likelihood of audit or detection when determining whether the realistic possibility standard has been met. The member should not prepare or sign a return that contains a frivolous position even if it is disclosed.

.30 Illustration 10—A statute is passed requiring the capitalization of certain expenditures. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will need to acquire new computer hardware and software and implement a number of new accounting procedures. The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare and sign a return on which the new requirement is simply ignored.

.31 Conclusion—The return position desired by the taxpayer is frivolous, and the member should neither prepare nor sign the return.

.32 Illustration 11—The facts are the same as in Illustration 10 except that a taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditures to be capitalized under the new provision.

.33 Conclusion—In this situation, the realistic possibility standard has been met. When using estimates in the preparation of a return, a member should refer to SSTS No. 4, *Use of Estimates* [section 400].

.34 Illustration 12—On a given issue, a member has located and weighed two authorities concerning the treatment of a particular expenditure. A taxing authority has issued an administrative ruling that required the expenditure to be capitalized and amortized over several years. On the other hand, a court opinion permitted the current deduction of the expenditure. The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.

.35 Conclusion—The realistic possibility standard is met by either position.

.36 Illustration 13—A tax statute is silent on the treatment of an item under the statute. However, the legislative history explaining the statute directs the taxing authority to issue regulations that will require a specific treatment of the item. No regulations have been issued at the time the member must recommend a position on the tax treatment of the item.

.37 Conclusion—The member may recommend the position supported by the legislative history because it meets the realistic possibility standard.

.38 Illustration 14—A taxpayer wants to take a position that a member concludes meets the realistic possibility standard based on an assumption regarding an underlying nontax legal issue. The member recommends that the taxpayer seek advice from its legal counsel, and the taxpayer's attorney gives an opinion on the nontax legal issue.

.39 Conclusion—A member may in general rely on a legal opinion on a nontax legal issue. A member should, however, use professional judgment when relying on a legal opinion. If, on its face, the opinion of the taxpayer's attorney appears to be unreasonable, unsubstantiated, or unwarranted, a member should consult his or her attorney before relying on the opinion.

.40 Illustration 15—A taxpayer has obtained from its attorney an opinion on the tax treatment of an item and requests that a member rely on the opinion.

.41 Conclusion—The authorities on which a member may rely include well-reasoned sources of tax analysis. If a member is satisfied about the source, relevance, and persuasiveness of the legal opinion, a member may rely on that opinion when determining whether the realistic possibility standard has been met.

[Issue Date: August, 2000.]

1-2. Tax Planning

Background

.42 SSTs are enforceable standards that govern the conduct of members of the AICPA in tax practice. A significant area of many members' tax practices involves assisting taxpayers in tax planning. Two of the eight SSTs issued as of the date of this Interpretation's release directly set forth standards that affect the most common activities in tax planning. Several other SSTs set forth standards related to specific factual situations that may arise while a member is assisting a taxpayer in tax planning. The two SSTs that are most typically relevant to tax planning are SSTS No. 1, *Tax Return Positions* [section 100], including Interpretation No. 1-1, "Realistic Possibility Standard" (paragraphs .01-.41), and SSTS No. 8, *Form and Content of Advice to Taxpayers* [section 800].

.43 Taxing authorities, courts, the AICPA, and other professional organizations have struggled with defining and regulating *tax shelters* and *abusive transactions*. Crucial to the debate is the difficulty of clearly distinguishing between transactions that are abusive and transactions that are legitimate. At the same time, it must be recognized that taxpayers have a legitimate interest in arranging their affairs so as to pay no more than the taxes they owe. It must be recognized that tax professionals, including members, have a role to play in advancing these efforts.

.44 This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in tax practice. It has its origins in the AICPA's desire to provide adequate guidance to its members when providing services in connection with tax planning. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards. It was determined that there was a compelling need for a comprehensive Interpretation of a member's responsibilities in connection with *tax planning*, with the recognition that such guidance would clarify how those standards would apply across the spectrum of tax planning, including those situations involving *tax shelters*, regardless of how that term is defined.

General Interpretation

.45 The realistic possibility standard (see SSTS No. 1, paragraph 2a [section 100.02a], and Interpretation No. 1–1 [paragraphs .01–.41]) applies to a member when providing professional services that involve *tax planning*. A member may still recommend a nonfrivolous position provided that the member recommends appropriate disclosure (see SSTS No. 1, paragraph 2c [section 100.02c]).

.46 For purposes of this Interpretation, *tax planning* includes, both with respect to prospective and completed transactions, recommending or expressing an opinion (whether written or oral) on (a) a tax return position or (b) a specific tax plan developed by the member, the taxpayer, or a third party.

.47 When issuing an opinion to reflect the results of the tax planning service, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction.
- Arrive at a conclusion supported by the authorities.

.48 In assisting a taxpayer in a tax planning transaction in which the taxpayer has obtained an opinion from a third party, and the taxpayer is looking to the member for an evaluation of the opinion, the member should be satisfied as to the source, relevance, and persuasiveness of the opinion, which would include considering whether the opinion indicates the third party did all of the following:

- Established the relevant background facts
- Considered the reasonableness of the assumptions and representations
- Applied the pertinent authorities to the relevant facts
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction
- Arrived at a conclusion supported by the authorities

.49 In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of either other procedures to support the advice or a representation from the taxpayer or another person. A member should also consider whether the member's tax advice will be communicated to third parties, particularly if those third parties may not be knowledgeable or may not be receiving independent tax advice with respect to a transaction.

.50 In tax planning, members often rely on assumptions and representations. Although such reliance is often necessary, the member must take care to assess whether such assumptions and representations are reasonable. In deciding whether an assumption or representation is reasonable, the member should consider its source and consistency with other information known to the member. For example, depending on the circumstances, it may be reasonable for a member to rely on a representation made by the taxpayer, but not on a representation made by a person who is selling or otherwise promoting the transaction to the taxpayer.

.51 When engaged in tax planning, the member should understand the business purpose and economic substance of the transaction when relevant to the tax consequences. If a transaction has been proposed by a party other than the taxpayer, the member should consider whether the assumptions made by the third party are consistent with the facts of the taxpayer's situation. If written advice is to be rendered concerning a transaction, the business purpose for the transaction generally should be described. If the business reasons are relevant to the tax consequences, it is insufficient to merely assume that a transaction is entered into for valid business reasons without specifying what those reasons are.

.52 The scope of the engagement should be appropriately determined. A member should be diligent in applying such procedures as are appropriate under the circumstances to understand and evaluate the entire transaction. The specific procedures to be performed in this regard will vary with the circumstances and the scope of the engagement.

Specific Illustrations

.53 The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in such general facts or to particular facts or circumstances may lead to different conclusions. In each illustration, there is no authority other than that indicated.

.54 *Illustration 1*—The relevant tax code imposes penalties on substantial underpayments that are not associated with tax shelters as defined in such code unless the associated positions are supported by substantial authority.

.55 *Conclusion*—In assisting the taxpayer in tax planning in which any associated underpayment would be substantial, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration that satisfies the realistic possibility of success standard, but does not possess sufficient authority to satisfy the substantial authority standard.

.56 *Illustration 2*—The relevant tax code imposes penalties on tax shelters, as defined in such code, unless the taxpayer concludes that a position taken on a tax return associated with such a tax shelter is, more likely than not, the correct position.

.57 *Conclusion*—In assisting the taxpayer in tax planning, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration that satisfies the realistic possibility of success standard, but does not possess sufficient authority to satisfy the more likely than not standard.

.58 *Illustration 3*—The relevant tax regulation provides that the details of (or certain information regarding) a specific transaction are required to be attached to the tax return, regardless of the support for the associated tax return position (for example, even if there is substantial authority or a higher level of comfort for the position). While preparing the taxpayer's return for the year, the member is aware that an attachment is required.

.59 *Conclusion*—In general, if the taxpayer agrees to include the attachment required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. However, if the taxpayer refuses to include the attachment, the member should not sign the return, unless the member concludes the

associated tax return position satisfies the realistic possibility standard and there are reasonable grounds for the taxpayer's position with respect to the attachment. In this regard, the member should consider SSTS No. 2, *Answers to Questions on Returns*, paragraphs 1 and 5, [section 200.01 and .05], which provides that the term *questions*, as used in the standard, "includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question," and that a "member should not omit an answer merely because it might prove disadvantageous to a taxpayer."

.60 Illustration 4—The relevant tax regulations provide that the details of certain potentially abusive transactions that are designated as "listed transactions" are required to be disclosed in attachments to tax returns, regardless of the support for the associated tax return position (for example, even if there is substantial authority or a higher level of support for the position). Under the regulations, if a listed transaction is not disclosed as required, the taxpayer will have additional penalty risks. While researching the tax consequences of a proposed transaction, a member concludes that the transaction is a listed transaction.

.61 Conclusion—Notwithstanding the member's conclusion that the transaction is a listed transaction, the member may still recommend a tax return position with respect to the transaction if he or she concludes that the proposed tax return position satisfies the realistic possibility standard. However, the member should inform the taxpayer of the enhanced disclosure requirements of listed transactions and the additional penalty risks for nondisclosure.

.62 Illustration 5—The same regulations apply as in Illustration 4. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that the taxpayer's transaction is a listed transaction.

.63 Conclusion—The member should inform the taxpayer of the enhanced disclosure requirement and the additional penalty risks for nondisclosure. If the taxpayer agrees to make the disclosure required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. Reasonable grounds for nondisclosure (see the conclusion to Illustration 3) generally are not present for a listed transaction. The member should not sign the return if the transaction is not disclosed. If the member is a nonsigning preparer of the return, the member should recommend that the taxpayer disclose the transaction.

.64 Illustration 6—The same regulations apply as in Illustration 4. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that there is uncertainty about whether the taxpayer's transaction is a listed transaction.

.65 Conclusion—The member should inform the taxpayer of the enhanced disclosure requirement and the additional penalty risks for nondisclosure. If the taxpayer agrees to make the disclosure required by the relevant regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. If the taxpayer does not want to disclose the transaction because of the uncertainty about whether it is a listed transaction, the member may sign the return if the

member concludes the associated tax return position satisfies the realistic possibility standard and there are reasonable grounds for the taxpayer's position with regard to nondisclosure. In this regard, the member should consider SSTS No. 2, paragraph 4 [section 200.04], which indicates that the degree of uncertainty regarding the meaning of a question on a return may affect whether there are reasonable grounds for not responding to the question.

.66 Illustration 7—A member advises a taxpayer concerning the tax consequences of a transaction involving a loan from a U.S. bank. In the process of reviewing documents associated with the proposed transaction, the member uncovers a reference to a deposit that a wholly owned foreign subsidiary of the taxpayer will make with an overseas branch of the U.S. bank. The transaction documents appear to indicate that this deposit is linked to the U.S. bank's issuance of the loan.

.67 Conclusion—The member should consider the effect, if any, of the deposit in advising the taxpayer about the tax consequences of the proposed transaction.

.68 Illustration 8—Under the relevant tax law, the tax consequences of a leasing transaction depend on whether the property to be leased is reasonably expected to have a residual value of 15 percent of its value at the beginning of the lease. The member has relied on a taxpayer's instruction to use a particular assumption concerning the residual value.

.69 Conclusion—Such reliance on the taxpayer's instructions may be appropriate if the assumption is supported by the expertise of the taxpayer, by the member's review of information provided by the taxpayer or a third party, or through the member's own knowledge or analysis.

.70 Illustration 9—A member is assisting a taxpayer with evaluating a proposed equipment leasing transaction in which the estimated residual value of the equipment at the end of the lease term is critical to the tax consequences of the lease. The broker arranging the leasing transaction has prepared an analysis that sets out an explicit assumption concerning the equipment's estimated residual value.

.71 Conclusion—The member should consider whether it is appropriate to rely on the broker's assumption concerning the estimated residual value of the equipment instead of obtaining a representation from the broker concerning estimated residual value or performing other procedures to validate the amount to be used as an estimate of residual value in connection with the member's advice. In considering the appropriateness of the broker's assumption, the member should consider, for example, factors such as the broker's experience in the area, the broker's methodology, and whether alternative sources of information are reasonably available.

.72 Illustration 10—The tax consequences of a particular reorganization depend, in part, on the majority shareholder of a corporation not disposing of any stock received in the reorganization pursuant to a prearranged agreement to dispose of the stock.

.73 Conclusion—The member should consider whether it is appropriate in rendering tax advice to assume that such a disposition will not occur or whether, under the circumstances, it is appropriate to request a written representation of the shareholder's intent concerning disposition as a condition to issuing an opinion on the reorganization.

.74 Illustration 11—A taxpayer is considering a proposed transaction. The taxpayer and the taxpayer's attorney advise the member that the member is responsible for advising the taxpayer on the tax consequences of the transaction.

.75 Conclusion—In addition to complying with the requirements of paragraph .47, the member generally should review all relevant draft transaction documents in formulating the member's tax advice relating to the transaction.

.76 Illustration 12—A member is responsible for advising a taxpayer on the tax consequences of the taxpayer's estate plan.

.77 Conclusion—Under the circumstances, the member should review the will and all other relevant documents to assess whether there appear to be any tax issues raised by the formulation or implementation of the estate plan.

.78 Illustration 13—A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support its recommendation, the investment bank offers a law firm's opinion on the tax consequences. The member reads the opinion, and notes that it is based on a hypothetical statement of facts rather than the taxpayer's facts.

.79 Conclusion—The member may rely on the law firm's opinion when determining whether the realistic possibility standard has been satisfied with respect to the tax consequences of the hypothetical transaction if the member is satisfied about the source, relevance, and persuasiveness of the opinion. However, the member should be diligent in taking such steps as are appropriate under the circumstances to understand and evaluate the transaction as it applies to the taxpayer's specific situation by:

- Establishing the relevant background facts
- Considering the reasonableness of the assumptions and representations
- Applying the pertinent authorities to the relevant facts
- Considering the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction (Mere reliance on a representation that there is business purpose or economic substance is generally insufficient.)
- Arriving at a conclusion supported by the authorities

.80 Illustration 14—The facts are the same as in Illustration 13 except the member also notes that the law firm that prepared the opinion is one that has a reputation as being knowledgeable about the tax issues associated with the proposed transaction.

.81 Conclusion—The conclusion is the same as the conclusion to Illustration 13, notwithstanding the expertise of the law firm.

.82 Illustration 15—A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support that recommendation, the investment bank offers a law firm's opinion about the tax consequences. The member reads the opinion, and notes that (unlike the opinions described in Illustrations 13 and 14), it is carefully tailored to the taxpayer's facts.

.83 Conclusion—The member may rely on the opinion when determining whether the realistic possibility standard has been met with respect to the taxpayer's participation in the transaction if the member is satisfied about the source, relevance, and persuasiveness of the opinion. In making that determination, the member should consider whether the opinion indicates the law firm did all of the following:

- Established the relevant background facts
- Considered the reasonableness of the assumptions and representations

- Applied the pertinent authorities to the relevant facts
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction (Mere reliance on a representation that there is business purpose or economic substance is generally insufficient.)
- Arrived at a conclusion supported by the authorities

.84 Illustration 16—The facts are the same as in Illustration 15, except the member also notes that the law firm that prepared the opinion is one that has a reputation of being knowledgeable about the tax issues associated with the proposed transaction.

.85 Conclusion—The conclusion is the same as the conclusion to Illustration 15, notwithstanding the expertise of the law firm.

.86 Illustration 17—A member is assisting a taxpayer with year-end planning in connection with the taxpayer's proposed contribution of stock in a closely held corporation to a charitable organization. The taxpayer instructs the member to calculate the anticipated tax liability assuming a contribution of 10,000 shares to a tax-exempt organization assuming the stock has a fair market value of \$100 per share. The member is aware that on the taxpayer's gift tax returns for the prior year, the taxpayer indicated that her stock in the corporation was worth \$50 per share.

.87 Conclusion—The member's calculation of the anticipated tax liability is subject to the general interpretations described in paragraphs .49 and .50. Accordingly, even though this potentially may be a case in which the value of the stock substantially appreciated during the year, the member should consider the reasonableness of the assumption and consistency with other information known to the member in connection with preparing the projection. The member should consider whether to document discussions concerning the increase in value of the stock with the taxpayer.

.88 Illustration 18—The tax consequences to Target Corporation's shareholders of an acquisition turn in part on Acquiring Corporation's continuance of the trade or business of Target Corporation for some time after the acquisition. The member is preparing a tax opinion addressed to Target's shareholders. A colleague has drafted a tax opinion for the member's review. That opinion makes an explicit assumption that Acquiring will continue Target's business for two years following the acquisition.

.89 Conclusion—In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of a representation from another person. In this case, the member should make reasonable efforts to obtain a representation from Acquiring Corporation concerning its plan to continue Target's business and further consider whether to request a written representation to that effect.

.90 Illustration 19—The member receives a telephone call from a taxpayer who is the sole shareholder of a corporation. The taxpayer indicates that he is thinking about exchanging his stock in the corporation for stock in a publicly traded business. During the call, the member explains how the transaction should be structured so it will qualify as a tax-free acquisition.

.91 Conclusion—Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, or complicated transactions. The member should use professional judgment about the need to document oral advice.

.92 *Illustration 20*—The member receives a telephone call from a taxpayer who wants to know whether he or she should lease or purchase a car. During the call, the member explains how the arrangement should be structured so as to help achieve the taxpayer's objectives.

.93 *Conclusion*—In this situation, the member's response is in conformity with this Interpretation in view of the routine nature of the inquiry and the well-defined tax issues. However, the member should evaluate whether other considerations, such as avoiding misunderstanding with the taxpayer, suggest that the conversation should be documented.

[Issue Date: December, 2003.]

[The next page is 18,041.]

TS Section 200

Answers to Questions on Returns

Issue date, unless
otherwise indicated:
August, 2000

Introduction

.01 This Statement sets forth the applicable standards for members when signing the preparer's declaration on a tax return if one or more questions on the return have not been answered. The term *questions* includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question.

Statement

.02 A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.

Explanation

.03 It is recognized that the questions on tax returns are not of uniform importance, and often they are not applicable to the particular taxpayer. Nevertheless, there are at least two reasons why a member should be satisfied that a reasonable effort has been made to obtain information to provide appropriate answers to the questions on the return that are applicable to a taxpayer.

- a. A question may be of importance in determining taxable income or loss, or the tax liability shown on the return, in which circumstance an omission may detract from the quality of the return.
- b. A member often must sign a preparer's declaration stating that the return is true, correct, and complete.

.04 Reasonable grounds may exist for omitting an answer to a question applicable to a taxpayer. For example, reasonable grounds may include the following:

- a. The information is not readily available and the answer is not significant in terms of taxable income or loss, or the tax liability shown on the return.
- b. Genuine uncertainty exists regarding the meaning of the question in relation to the particular return.
- c. The answer to the question is voluminous; in such cases, a statement should be made on the return that the data will be supplied upon examination.

.05 A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.

.06 If reasonable grounds exist for omission of an answer to an applicable question, a taxpayer is not required to provide on the return an explanation of the reason for the omission. In this connection, a member should consider whether the omission of an answer to a question may cause the return to be deemed incomplete.

[The next page is 18,051.]

TS Section 300***Certain Procedural Aspects of
Preparing Returns***

**Issue date, unless
otherwise indicated:
August, 2000**

Introduction

.01 This Statement sets forth the applicable standards for members concerning the obligation to examine or verify certain supporting data or to consider information related to another taxpayer when preparing a taxpayer's tax return.

Statement

.02 In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member. Further, a member should refer to the taxpayer's returns for one or more prior years whenever feasible.

.03 If the tax law or regulations impose a condition with respect to deductibility or other tax treatment of an item, such as taxpayer maintenance of books and records or substantiating documentation to support the reported deduction or tax treatment, a member should make appropriate inquiries to determine to the member's satisfaction whether such condition has been met.

.04 When preparing a tax return, a member should consider information actually known to that member from the tax return of another taxpayer if the information is relevant to that tax return and its consideration is necessary to properly prepare that tax return. In using such information, a member should consider any limitations imposed by any law or rule relating to confidentiality.

Explanation

.05 The preparer's declaration on a tax return often states that the information contained therein is true, correct, and complete to the best of the preparer's knowledge and belief based on all information known by the preparer. This type of reference should be understood to include information furnished by the taxpayer or by third parties to a member in connection with the preparation of the return.

.06 The preparer's declaration does not require a member to examine or verify supporting data. However, a distinction should be made between (a) the need either to determine by inquiry that a specifically required condition, such

as maintaining books and records or substantiating documentation, has been satisfied or to obtain information when the material furnished appears to be incorrect or incomplete and (b) the need for a member to examine underlying information. In fulfilling his or her obligation to exercise due diligence in preparing a return, a member may rely on information furnished by the taxpayer unless it appears to be incorrect, incomplete, or inconsistent. Although a member has certain responsibilities in exercising due diligence in preparing a return, the taxpayer has the ultimate responsibility for the contents of the return. Thus, if the taxpayer presents unsupported data in the form of lists of tax information, such as dividends and interest received, charitable contributions, and medical expenses, such information may be used in the preparation of a tax return without verification unless it appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member.

.07 Even though there is no requirement to examine underlying documentation, a member should encourage the taxpayer to provide supporting data where appropriate. For example, a member should encourage the taxpayer to submit underlying documents for use in tax return preparation to permit full consideration of income and deductions arising from security transactions and from pass-through entities, such as estates, trusts, partnerships, and S corporations.

.08 The source of information provided to a member by a taxpayer for use in preparing the return is often a pass-through entity, such as a limited partnership, in which the taxpayer has an interest but is not involved in management. A member may accept the information provided by the pass-through entity without further inquiry, unless there is reason to believe it is incorrect, incomplete, or inconsistent, either on its face or on the basis of other facts known to the member. In some instances, it may be appropriate for a member to advise the taxpayer to ascertain the nature and amount of possible exposure to tax deficiencies, interest, and penalties, by contact with management of the pass-through entity.

.09 A member should make use of a taxpayer's returns for one or more prior years in preparing the current return whenever feasible. Reference to prior returns and discussion of prior-year tax determinations with the taxpayer should provide information to determine the taxpayer's general tax status, avoid the omission or duplication of items, and afford a basis for the treatment of similar or related transactions. As with the examination of information supplied for the current year's return, the extent of comparison of the details of income and deduction between years depends on the particular circumstances.

[The next page is 18,061.]

TS Section 400

Use of Estimates

Issue date, unless
otherwise indicated:
August, 2000

Introduction

.01 This Statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but the taxpayer has the responsibility to provide the estimated data. Appraisals or valuations are not considered estimates for purposes of this Statement.

Statement

.02 Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. If the taxpayer's estimates are used, they should be presented in a manner that does not imply greater accuracy than exists.

Explanation

.03 Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this Statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

.04 When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.

.05 When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.

.06 Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

.07 Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual

circumstances where nondisclosure might mislead the taxing authority regarding the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:

- a.* A taxpayer has died or is ill at the time the return must be filed.
 - b.* A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
 - c.* There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
 - d.* Fire or computer failure has destroyed the relevant records.
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[The next page is 18,071.]

TS Section 500

Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision

Issue date, unless
otherwise indicated:
August, 2000

Introduction

.01 This Statement sets forth the applicable standards for members in recommending a tax return position that departs from the position determined in an administrative proceeding or in a court decision with respect to the taxpayer's prior return.

.02 For purposes of this Statement, *administrative proceeding* also includes an examination by a taxing authority or an appeals conference relating to a return or a claim for refund.

.03 For purposes of this Statement, *court decision* means a decision by any court having jurisdiction over tax matters.

Statement

.04 The tax return position with respect to an item as determined in an administrative proceeding or court decision does not restrict a member from recommending a different tax position in a later year's return, unless the taxpayer is bound to a specified treatment in the later year, such as by a formal closing agreement. Therefore, as provided in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100], the member may recommend a tax return position or prepare or sign a tax return that departs from the treatment of an item as concluded in an administrative proceeding or court decision with respect to a prior return of the taxpayer.

Explanation

.05 If an administrative proceeding or court decision has resulted in a determination concerning a specific tax treatment of an item in a prior year's return, a member will usually recommend this same tax treatment in subsequent years. However, departures from consistent treatment may be justified under such circumstances as the following:

- a. Taxing authorities tend to act consistently in the disposition of an item that was the subject of a prior administrative proceeding but generally are not bound to do so. Similarly, a taxpayer is not bound to follow the tax treatment of an item as consented to in an earlier administrative proceeding.

- b.* The determination in the administrative proceeding or the court's decision may have been caused by a lack of documentation. Supporting data for the later year may be appropriate.
- c.* A taxpayer may have yielded in the administrative proceeding for settlement purposes or not appealed the court decision, even though the position met the standards in SSTS No. 1 [section 100].
- d.* Court decisions, rulings, or other authorities that are more favorable to a taxpayer's current position may have developed since the prior administrative proceeding was concluded or the prior court decision was rendered.

.06 The consent in an earlier administrative proceeding and the existence of an unfavorable court decision are factors that the member should consider in evaluating whether the standards in SSTS No. 1 [section 100] are met.

[The next page is 18,081.]

TS Section 600***Knowledge of Error: Return Preparation***

Issue date, unless
otherwise indicated:
August, 2000

Introduction

.01 This Statement sets forth the applicable standards for a member who becomes aware of an error in a taxpayer's previously filed tax return or of a taxpayer's failure to file a required tax return. As used herein, the term error includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100]. The term *error* also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retroactive effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability.

.02 This Statement applies whether or not the member prepared or signed the return that contains the error.

Statement

.03 A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return or upon becoming aware of a taxpayer's failure to file a required return. A member should recommend the corrective measures to be taken. Such recommendation may be given orally. The member is not obligated to inform the taxing authority, and a member may not do so without the taxpayer's permission, except when required by law.

.04 If a member is requested to prepare the current year's return and the taxpayer has not taken appropriate action to correct an error in a prior year's return, the member should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer. If the member does prepare such current year's return, the member should take reasonable steps to ensure that the error is not repeated.

Explanation

.05 While performing services for a taxpayer, a member may become aware of an error in a previously filed return or may become aware that the taxpayer failed to file a required return. The member should advise the taxpayer of the error and the measures to be taken. Such recommendation may be given orally. If the member believes that the taxpayer could be charged with fraud or other criminal misconduct, the taxpayer should be advised to consult legal counsel before taking any action.

.06 It is the taxpayer's responsibility to decide whether to correct the error. If the taxpayer does not correct an error, a member should consider whether to continue a professional or employment relationship with the taxpayer. While recognizing that the taxpayer may not be required by statute to correct an error by filing an amended return, a member should consider whether a taxpayer's decision not to file an amended return may predict future behavior that might require termination of the relationship. The potential for violating Code of Professional Conduct rule 301 [ET section 301.01] (relating to the member's confidential client relationship), the tax law and regulations, or laws on privileged communications, and other considerations may create a conflict between the member's interests and those of the taxpayer. Therefore, a member should consider consulting with his or her own legal counsel before deciding upon recommendations to the taxpayer and whether to continue a professional or employment relationship with the taxpayer.

.07 If a member decides to continue a professional or employment relationship with the taxpayer and is requested to prepare a tax return for a year subsequent to that in which the error occurred, the member should take reasonable steps to ensure that the error is not repeated. If the subsequent year's tax return cannot be prepared without perpetuating the error, the member should consider withdrawal from the return preparation. If a member learns that the taxpayer is using an erroneous method of accounting and it is past the due date to request permission to change to a method meeting the standards of SSTS No. 1 [section 100], the member may sign a tax return for the current year, providing the tax return includes appropriate disclosure of the use of the erroneous method.

.08 Whether an error has no more than an insignificant effect on the taxpayer's tax liability is left to the professional judgment of the member based on all the facts and circumstances known to the member. In judging whether an erroneous method of accounting has more than an insignificant effect, a member should consider the method's cumulative effect and its effect on the current year's tax return.

.09 If a member becomes aware of the error while performing services for a taxpayer that do not involve tax return preparation, the member's responsibility is to advise the taxpayer of the existence of the error and to recommend that the error be discussed with the taxpayer's tax return preparer. Such recommendation may be given orally.

[The next page is 18,091.]

TS Section 700***Knowledge of Error: Administrative Proceedings***

**Issue date, unless
otherwise indicated:
August, 2000**

Introduction

.01 This Statement sets forth the applicable standards for a member who becomes aware of an error in a return that is the subject of an administrative proceeding, such as an examination by a taxing authority or an appeals conference. The term *administrative proceeding* does not include a criminal proceeding. As used herein, the term *error* includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100]. The term *error* also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retro-active effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability.

.02 This Statement applies whether or not the member prepared or signed the return that contains the error. Special considerations may apply when a member has been engaged by legal counsel to provide assistance in a matter relating to the counsel's client.

Statement

.03 If a member is representing a taxpayer in an administrative proceeding with respect to a return that contains an error of which the member is aware, the member should inform the taxpayer promptly upon becoming aware of the error. The member should recommend the corrective measures to be taken. Such recommendation may be given orally. A member is neither obligated to inform the taxing authority nor allowed to do so without the taxpayer's permission, except where required by law.

.04 A member should request the taxpayer's agreement to disclose the error to the taxing authority. Lacking such agreement, the member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer.

Explanation

.05 When the member is engaged to represent the taxpayer before a taxing authority in an administrative proceeding with respect to a return containing an error of which the member is aware, the member should advise

the taxpayer to disclose the error to the taxing authority. Such recommendation may be given orally. If the member believes that the taxpayer could be charged with fraud or other criminal misconduct, the taxpayer should be advised to consult legal counsel before taking any action.

.06 It is the taxpayer's responsibility to decide whether to correct the error. If the taxpayer does not correct an error, a member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer. While recognizing that the taxpayer may not be required by statute to correct an error by filing an amended return, a member should consider whether a taxpayer's decision not to file an amended return may predict future behavior that might require termination of the relationship. Moreover, a member should consider consulting with his or her own legal counsel before deciding on recommendations to the taxpayer and whether to continue a professional or employment relationship with the taxpayer. The potential for violating Code of Professional Conduct rule 301 [ET section 301.01] (relating to the member's confidential client relationship), the tax law and regulations, laws on privileged communications, potential adverse impact on a taxpayer of a member's withdrawal, and other considerations may create a conflict between the member's interests and those of the taxpayer.

.07 Once disclosure is agreed on, it should not be delayed to such a degree that the taxpayer or member might be considered to have failed to act in good faith or to have, in effect, provided misleading information. In any event, disclosure should be made before the conclusion of the administrative proceeding.

.08 Whether an error has an insignificant effect on the taxpayer's tax liability is left to the professional judgment of the member based on all the facts and circumstances known to the member. In judging whether an erroneous method of accounting has more than an insignificant effect, a member should consider the method's cumulative effect and its effect on the return that is the subject of the administrative proceeding.

[The next page is 18,101.]

TS Section 800***Form and Content of Advice to Taxpayers***

Issue date, unless
otherwise indicated:
August, 2000

Introduction

.01 This Statement sets forth the applicable standards for members concerning certain aspects of providing advice to a taxpayer and considers the circumstances in which a member has a responsibility to communicate with a taxpayer when subsequent developments affect advice previously provided. The Statement does not, however, cover a member's responsibilities when the expectation is that the advice rendered is likely to be relied on by parties other than the taxpayer.

Statement

.02 A member should use judgment to ensure that tax advice provided to a taxpayer reflects professional competence and appropriately serves the taxpayer's needs. A member is not required to follow a standard format or guidelines in communicating written or oral advice to a taxpayer.

.03 A member should assume that tax advice provided to a taxpayer will affect the manner in which the matters or transactions considered would be reported on the taxpayer's tax returns. Thus, for all tax advice given to a taxpayer, a member should follow the standards in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100].

.04 A member has no obligation to communicate with a taxpayer when subsequent developments affect advice previously provided with respect to significant matters, except while assisting a taxpayer in implementing procedures or plans associated with the advice provided or when a member undertakes this obligation by specific agreement.

Explanation

.05 Tax advice is recognized as a valuable service provided by members. The form of advice may be oral or written and the subject matter may range from routine to complex. Because the range of advice is so extensive and because advice should meet the specific needs of a taxpayer, neither a standard format nor guidelines for communicating or documenting advice to the taxpayer can be established to cover all situations.

.06 Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, or complicated transactions. The member may use professional judgment about whether, subsequently, to document oral advice in writing.

.07 In deciding on the form of advice provided to a taxpayer, a member should exercise professional judgment and should consider such factors as the following:

- a.* The importance of the transaction and amounts involved
- b.* The specific or general nature of the taxpayer's inquiry
- c.* The time available for development and submission of the advice
- d.* The technical complications presented
- e.* The existence of authorities and precedents
- f.* The tax sophistication of the taxpayer
- g.* The need to seek other professional advice

.08 A member may assist a taxpayer in implementing procedures or plans associated with the advice offered. When providing such assistance, the member should review and revise such advice as warranted by new developments and factors affecting the transaction.

.09 Sometimes a member is requested to provide tax advice but does not assist in implementing the plans adopted. Although such developments as legislative or administrative changes or future judicial interpretations may affect the advice previously provided, a member cannot be expected to communicate subsequent developments that affect such advice unless the member undertakes this obligation by specific agreement with the taxpayer.

.10 Taxpayers should be informed that advice reflects professional judgment based on an existing situation and that subsequent developments could affect previous professional advice. Members may use precautionary language to the effect that their advice is based on facts as stated and authorities that are subject to change.

.11 In providing tax advice, a member should be cognizant of applicable confidentiality privileges.

[The next page is 18,111.]

TS Section 900

Appendix: Cross-Reference of Previous and Revised Statements

<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>
1	111	Withdrawn 1982	—	
2	121	Withdrawn 1982	—	
3	131	Superseded by Statement No. 2, August 1988	122	
3	131	Superseded by Statement No. 2, August 2000		200
4	141	Superseded by Statement No. 5, August 1988	152	
4	141	Superseded by Statement No. 5, August 2000		500
5	151	Superseded by Statement No. 4, August 1988	142	
5	151	Superseded by Statement No. 4, August 2000		400
6	161	Superseded by Statement No. 6, August 1988; Revised May 1991	162	
6	161	Superseded by Statement No. 6, August 2000		600
7	171	Superseded by Statement No. 7, August 1988; Revised May 1991	172	
7	171	Superseded by Statement No. 7, August 2000		700
8	181	Superseded by Statement No. 8, August 1988	182	
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